

Tilburg University

Retroactive and retrospective tax legislation

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Published in:
Retroactivity of tax legislation

Publication date:
2013

Document Version
Publisher's PDF, also known as Version of record

[Link to publication in Tilburg University Research Portal](#)

Citation for published version (APA):
Pauwels, M. R. T. (2013). Retroactive and retrospective tax legislation: A principle based approach; a theory about 'priority principles of transition law' and 'the method of the catalogue of circumstances'. In H. Gribnau, & M. Pauwels (Eds.), *Retroactivity of tax legislation* (pp. 95-116). (EATLP International Tax Series; No. 9). EATLP / IBFD.

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2.2.

Retroactive and retrospective tax legislation: a principle-based approach; a theory of ‘priority principles of transitional law’ and ‘the method of the catalogue of circumstances’

Melvin Pauwels

2.2.1. Introduction

The principle of legal certainty is a fundamental principle of law. Citizens, taxpayers, should in general be allowed to rely on the legislation in force to plan their conduct and transactions. The government, including the legislator, should respect the principle of legal certainty. However, it is beyond discussion that the legislator should be able to change its legislation, including tax legislation. There are various justified reasons to change tax legislation, such as a change of tax policy and social and technical developments. A change in legislation could, however, infringe taxpayers’ expectations raised by the existing legislation. This could especially be the case if the legislator decides that the amended legislation is applicable to past tax periods (the change has ‘retroactive effect’). But also if the amended legislation has ‘immediate effect’ and therefore only applies to future taxable events or tax periods, taxpayers’ expectations could be at stake. This would be the case if the legislator does not provide for grandfathering. Then, the changed legislation also applies to future effects of a situation that arose under the old legislation (the change has ‘retrospective effect’).

The above in a nutshell is the problem which the tax legislator has to deal with when changing legislation. How should the tax legislator act, taking into account the colliding interests? Which method should the legislature apply in determining to what extent retroactivity and retrospectivity are acceptable when enacting tax legislation? In my PhD dissertation I dealt with this issue and I developed a framework for the tax legislator grounded on a principle-based approach.¹ This contribution presents the main lines and results of my research. It should be noted that this contribution only deals with retroactive and retrospective substantive tax legislation that is disadvantageous for taxpayers. Thus, issues like *advantageous* retroactivity and retrospectivity, *procedural* tax legislation and retroactivity of *case law* are not specifically addressed.

Lastly, for various reasons, the contribution does not deal with limits in the Constitution to transitional law, and thus not with such limits to retroactivity. First of all, countries have different constitutional limits (including no limits to the sovereignty of the legislator

1. M.R.T. Pauwels, *Terugwerkende kracht van belastingwetgeving: gewikt en gewogen* (Retroactivity of tax legislation: weighing and balancing) (Amersfoort: Sdu Uitgevers, 2009).

in this respect), while this contribution seeks to offer a general approach to deal with transitional law. Notwithstanding this, the framework I advocate in this contribution can be combined with constitutional limits. Secondly, even if there are constitutional limits, these limits usually leave room for the legislator. In general, within the constitutional boundaries, the legislator should in my view aim to make the most optimal law, thereby including the most optimal transitional law. In terms of the legal theorist Lon Fuller: there is not only a *morality of duty* but also a *morality of aspiration*.² Therefore, a framework offers the legislator useful guidance.

2.2.2. Overview

This contribution deals in particular with two theoretical issues in the field of transitional law that are of special interest. The first concerns the two principles of transitional law that are generally accepted. These principles are (i) that a change in legislation should not have retroactive effect and (ii) that a change in legislation has immediate effect, without grandfathering, which implies that the legislation could be 'retrospective'. As I discuss below (section 2.2.4), from a legal certainty point of view, the distinction between retroactive effect and immediate effect (which could imply a 'retrospective effect') is not strict, but only gradual. Taking this point into account, the question arises what the justification is of the above-mentioned principles of transitional law that are generally accepted. This is the first main issue I address in this contribution.

The second main issue relates to a related subject. It is generally accepted that under certain circumstances the legislator is allowed, or even should, deviate from the above-mentioned principles of transitional law. The concept of 'legitimate expectations' has a key role in this respect. On the one hand, if no legitimate expectations are infringed, retroactivity may be permissible. On the other hand, if the immediate effect (retrospectivity) would infringe legitimate expectations, the legislator should provide for grandfathering or another transitional provision. However, the question is when expectations can be characterized as 'legitimate' and how this should be assessed. This is the second main issue I scrutinize in this contribution.

The discussion of these two issues makes up the core of this contribution. However, before these issues can be dealt with, it is necessary to outline in brief which theory of law I use as the theoretical framework. Subsequently I deal with the principle of legal certainty. I then go on to analyse the two main subjects.

2.2.3. Theoretical framework: a principle-based approach³

2.2.3.1. Introduction

The answer to the question which method the legislature ought to apply in determining to what extent retroactivity and retrospectivity is acceptable when enacting tax legislation depends on the legal theory that is adopted. A law and economics view will provide a different answer, or at least a different approach, than a more traditional legal view.⁴ Law and

2. L.L. Fuller, *The Morality of Law* (New Haven/London: Yale University Press, 1977), at pp. 9-15.

3. See in detail Pauwels, *supra* note 1, chapter 3.

4. See for law and economics approaches on (tax) transitional law especially M.J. Graetz, 'Legal Transitions: The Case of Retroactivity in Income Tax Revision', *University of Pennsylvania Law Review* (1977), at pp. 47-87, M.J. Graetz, 'Retroactivity Revisited', *Harvard Law Review* (1985), at pp. 1820-1841, L. Kaplow, 'An Economic Analysis of Legal Transitions', *Harvard Law Review* (1986), at pp. 509-617 and D.N. Shaviro, *When Rules Change: An Economic and Political Analysis of Transition Relief and Retroactivity* (Chicago: University of Chicago Press, 2000). Note that there are some differences between these approaches.

economics scholars strongly emphasize the objective of an increase in prosperity (utilitarianism) and seem not to attach independent value to legal certainty.⁵ In the more traditional legal view – called the ‘old view’ by law and economics scholars⁶ – legal certainty has an independent value, being a key value of law. This difference already provides an indication that the evaluation of retroactivity and retrospectivity will differ.

This contribution takes, for empirical as well as normative reasons, the traditional legal view. I do not elaborate on these reasons in this contribution,⁷ but in essence the reasons are that (empirically:) the practice of law (legislation, case law, an important part of the legal literature) shows that legal certainty is considered a key value of law and that (normatively:) law and the legal system should aspire to the enhancement of legal certainty, since legitimate law without legal certainty is hardly conceivable (compare Fuller’s idea of the morality of law, to be discussed in section 2.2.4.2).

Furthermore, I note with respect to the law and economics view and its apparent undervaluation of the value of legal certainty that, interestingly, some economists do criticize the traditional economic standards of measurement. For example, in his recent book, the famous economist Stiglitz – winner of the 2001 Nobel Prize in economics – argues that the traditional measurement in GDP (Gross Domestic Product) is not adequate, for it fails to take into account values that are important for social welfare. In this respect, Stiglitz explicitly refers to the values of security and certainty.⁸ Moreover, continuously in this book, Stiglitz criticizes assumptions on which the neo-capitalist theory (‘market fundamentalism’) is based, especially the theory of rational markets, of which one element is the assumption that people behave rationally. The latter idea is interesting with respect to the law and economics view on transitional law, since this view is, amongst other things, based on the – thus criticized – assumption that people have rational expectations.⁹

Notwithstanding the above, in my view, the law and economics literature on transitional law offers valuable insights *in addition to* insights of the more traditional legal literature on transitional law. I use these added value elements to improve the traditional legal theory on transitional law.

2.2.3.2. From Radbruch to Dworkin and Alexy

The starting point for the development of my theoretical framework is Radbruch’s abstract legal theory. In short, his theory is that law ought to be directed towards the realization of the idea of law, that is *Gerechtigkeit*, and that three elements, values, can be discerned therein.¹⁰ These values are equality (*Gleichheit*), purposiveness (*Zweckmäßigkeit*), and legal certainty (*Rechtssicherheit*). Between these values there is a tension and none of these values

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5. Hans Gribnau and Melvin Pauwels, ‘Retroactivity and Tax Legislation in the Netherlands. A theoretical approach and assessment’, *International Tax Law Review* (2009), at pp. 144-145.
 6. See in that respect K.D. Logue, ‘Tax Transitions, Opportunistic Retroactivity, and the Benefits of Government Precommitment’, *Michigan Law Review* (1996), at p. 1136 and Shaviro, *supra* note 4, at pp. 2-3.
 7. See Pauwels, *supra* note 1 and Gribnau and Pauwels, *supra* note 5.
 8. Joseph E. Stiglitz, *Freefall: America, Free Markets, and the Sinking of the World Economy* (New York/London: W. W. Norton & Company, 2010), chapter 10.
 9. See Graetz, *Legal Transitions*, *supra* note 4, at p. 75, Kaplow, *supra* note 4, at pp. 523-524 and Shaviro, *supra* note 4, at p. 19. K.D. Logue, ‘Legal Transitions, Rational Expectations, and Legal Progress’, *Journal of Contemporary Legal Issues* (2003), at p. 221 notes that the ‘rational expectations assumption’ is essential in the normative economic analysis of legal rules in general.
 10. G. Radbruch, *Rechtsphilosophie*. Studienausgabe, herausgegeben von Ralf Dreier und Stanley L. Paulson (Heidelberg: C.F. Müller Verlag, 2003), at pp. 34-41, 54-62 and at pp. 73-78. See for a summary and discussion of Radbruch’s theory for example S. Taekema, *The Concept of Ideals in Legal Theory* (2000) PhD dissertation, Tilburg University, at pp. 50-74.

ought to be made absolute.¹¹ 'Die Drei Bestandteile der Rechtsidee fordern einander – aber sie widersprechen zugleich einander.'¹² Here, on this abstract level, a difference from the approach of law and economics becomes clear. As the latter approach emphasizes the purpose of increase in prosperity, this approach can be seen as a theory in which the realization of the value of purposiveness takes priority over realization of the value of legal certainty. Such an *a priori* ranking between values does not exist in Radbruch's approach.

Radbruch's theory of law can be elaborated at a less abstract level by following Dworkin's theory.¹³ Dworkin considers law to be not a 'bunch of rules', but the integrity of rules and principles. Dworkin describes a legal principle as 'a standard to be observed, not because it will advance or secure an economic, political or social situation deemed desirable, but because it is a requirement of justice or fairness or some other dimension of morality.'¹⁴ Also Alexy emphasizes the normative value of legal principles. He describes legal principles as 'optimization commands'; they are 'norms commanding that something be realized to the highest degree that is actually and legally possible.'¹⁵ Legal principles are not purely moral principles; they are standards which are specific for the law.¹⁶ Since fundamental legal principles constitute the legal expressions of the basic values of a society, lawmaking should conform to legal principles. The body of laws – statute law, case law, and the decisions and regulations of the administration – should be 'consistent in principle.'¹⁷

An important feature of a principle of law is its argumentative character and its dimension of weight.¹⁸ A principle of law does not dictate a decision or outcome but provides an argument pointing in a certain direction. If there is a principle that provides an argument in another direction in the case concerned, the competing principles ought to be balanced.

The process of balancing of principles is an argumentative process; the relative weight of the arguments should be assessed in order to assess which principle gets priority in the case at hand. In this respect Alexy's law of balancing is relevant: 'The greater the degree of non-satisfaction of, or detriment to, one right or principle, the greater must be the importance of satisfying the other'.¹⁹ Notwithstanding that this law of balancing is a helpful conceptual guideline, in my opinion it cannot always be fully justified as to why one result of balancing is better than the other. This phenomenon is connected with the issue of incommensurability of principles. For example, if the principle of legal certainty and the principle of equality collide in a certain case and the judge (or the legislator) rules that the first principle supersedes the second principle in the case at hand, it is not always possible to *fully* justify in rational terms why the principle of legal certainty wins in that case. Often, there is ultimately an 'unguided jump'.²⁰ This is caused by the absence of a common unit of

11. Radbruch, *supra* note 10, at pp. 74ff.

12. Radbruch, *supra* note 10, at p. 74.

13. Dworkin himself does not explicitly base his theory on Radbruch's theory. However, both theories can be theoretically connected in the sense that a legal principle-based theory, such as Dworkin's theory, is compatible with the legal value theory of Radbruch. See in this respect Taekema, *supra* note 10, at pp. 78-83.

14. R. Dworkin, *Taking Rights Seriously* (Cambridge: Harvard University Press, 1978), at p. 22.

15. R. Alexy, 'On the Structure of Legal Principles', *Ratio Juris* (2000), at p. 295.

16. Actual moral principles will be among the influences on the actual content of general legal principles. See H. Gribnau, 'General Introduction', in: G.T.K. Meussen, ed., *The Principle of Equality in European Taxation* (The Hague/London/Boston: Kluwer Law International, 1999).

17. R. Dworkin, *Law's Empire* (Cambridge: Harvard University Press, 1986), at pp. 225-275.

18. Dworkin, *supra* note 14, at pp. 22-28. Compare also Alexy, *supra* note 16, at pp. 295ff, and E. Burg, *The Model of Principles* (2000), PhD dissertation, University of Amsterdam, at pp. 79-86.

19. R. Alexy, 'On Balancing and Subsumption. A Structural Comparison', *Ratio Juris* (2003), at p. 436.

20. Burg, *supra* note 18, at pp. 69 and 113.

measurement for weighing principles – principles are incommensurable.²¹ Nevertheless, it can be demanded of the authority (the legislator, the judge, etc.) who balances principles that he or it be consistent in that activity.²² Thus, the results of balancing in comparable situations should be the same, or at least should not deviate without justification.

2.2.3.3. The case of retroactivity and retrospectivity: a balancing act

What is the meaning of the above for the subject at hand? First of all, a main implication is that the government is bound by principles of law. After all, principles are ‘standards to be observed’ (Dworkin); they are optimization commands (Alexy). This also applies to the legislature when it comes to lawmaking, including the making of transitional law. Secondly, principles are not absolute. Hence, notwithstanding that the principle of legal certainty, including the principle of honouring legitimate expectations, provides strong arguments *contra* retroactivity, this does not imply that there is an absolute ban on retroactivity. In a certain case, certain interests could be served if the legislator were to grant retroactive effect to legislation. In that case the competing interests and principles should be weighed. The same applies *mutatis mutandis* for the subject of retrospectivity. Thus, the case of retroactivity and retrospectivity is a *balancing act* for the legislator. Thirdly, it should be accepted that the result of the balancing cannot always be fully accounted for. This relates to the issue of incommensurability of principles. Nevertheless, the demand for consistency of the legislator when balancing implies that if legislative situations are comparable²³ the transitional law should in principle be comparable.

2.2.4. Retroactivity and retrospectivity in view of legal certainty

2.2.4.1. Introduction

Legal certainty has a two-fold value, one is intrinsic, the other instrumental.²⁴ Legal certainty’s intrinsic value regards the notion of personal freedom. First and foremost, this concerns the liberty to do and not do as one pleases. This is often called ‘negative liberty’, the liberty to choose between alternative courses of action without interference by others.²⁵ People want to be sure about the legal consequences of their dealings. In tax law this certainty regards the ‘reach’ of tax law and the inroad upon taxpayer’s economic freedom, i.e. his tax burden.

Secondly, legal certainty has an instrumental aspect. Tax legislation is not only a constraint, but may also be an opportunity for taxpayers. Nowadays, the use of tax legislation for non-fiscal goals is an integral part of government policy: the instrumentalist tax legisla-

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21. See with respect to the issue of incommensurability in law for example J. Raz, *The Morality of Freedom* (Oxford: Clarendon Press, 1986), at pp. 321-366, T.A. Aleinikoff, ‘Constitutional Law in the Age of Balancing’, *The Yale Law Journal* (1987), at pp. 972-976, Burg, *supra* note 19, at pp. 116-119 and T.A.O. Endicott, *Vagueness in Law* (Oxford: Oxford University Press, 2000), at pp. 41-45 en 148-155.
 22. Compare Dworkin’s requirement of integrity of the law, Dworkin, *supra* note 17, at pp. 165, 189 and 217-218. See for the requirement of consistency also Burg, *supra* note 18, at pp. 70-73 and at pp. 151-152.
 23. This should be assessed on the basis of the principles and interests involved and the relevant circumstances of the legislative cases concerned.
 24. See Gribnau and Pauwels, *supra* note 5, at pp. 143-144.
 25. I. Berlin, ‘Two Concepts of Liberty’ [1958], in: I. Berlin, ed., *Four Essays on Liberty* (Oxford: Oxford University Press, 1969).

tor seduces taxpayers to behave according to his ends.²⁶ Consequently, Netherlands tax law contains all kinds of instrumentalist incentives mostly in the form of tax reductions.

Both the intrinsic and the instrumental values imply that certainty about the law enables people to make rational choices and to plan their activities at large. Thus, it is clear why legal certainty is important and what it should enable, but what does 'legal certainty' actually involve?

2.2.4.2. The concept of legal certainty: an aspects concept

The concept of legal certainty is not an easy one. Tridimas is right when he states: 'Legal certainty is by its nature diffuse, perhaps more so than any other general principle, and its precise content is difficult to pin down.'²⁷ As soon as one tries to make the concept concrete or describe what 'legal certainty' involves, one easily starts to sum up requirements: the law should be published, it should be clear, etc. In my view, the concept of legal certainty should be regarded as an 'aspects concept': a concept that consists of various aspects.²⁸

Here, the well-known desiderata formulated by Lon Fuller for the sake of the 'inner morality of law' spring to mind.²⁹ Although Fuller deals with the desiderata in the light of the principle of legality, they are all also aspects of legal certainty.³⁰ These desiderata constitute the 'internal morality of law', the morality that makes law possible. Fuller's desiderata are nowadays still important. Fuller's theory is often used as a starting point for further elaboration, discussion and refinement of the principle of legal certainty.³¹

First, Fuller mentions the generality of law, i.e., 'there must be rules.' General rules promote legal certainty. In a state under the rule of law it is hardly possible to control and direct human conduct without rules applying to general classes of people. A second demand is the promulgation of laws. Legal rules ought to be published. Citizens are entitled to know the law in advance, which enables them to predict the legal consequences of their behaviour and it also allows for public criticism. Thirdly, Fuller criticizes retroactivity: in itself 'a retroactive law is truly a monstrosity'. Note, however, that also in Fuller's view there is no absolute ban on retroactivity. According to Fuller, situations may arise in which granting retroactive effect to legal rules, 'not only becomes tolerable, but may actually be essential to advance the cause of legality.' Fourth, Fuller argues that the clarity of laws is essential to control and direct human conduct. A fifth desideratum is rather obvious: rules must not require contradictory actions. A further desideratum is that laws should not require the impossible. A last requirement which regards the law itself holds that laws should not be changed too frequently. Frequent changes make it harder for people to gear their activities to the law. This demand for the constancy of the law directly serves the predictability of legislation and the legislator's reliability. As Fuller points out, there is a close affinity between the harm resulting from too frequent changes in the law and that done by retroac-

26. J.L.M. Gribnau, 'Equality, Consistency, and Impartiality in Tax Legislation', in J.L.M. Gribnau, ed., *Legal Protection against Discriminatory Tax Legislation: The Struggle for Equality in European Tax Law* (The Hague/London/Boston: Kluwer Law International, 2003), at pp. 25-27.

27. T. Tridimas, *The General Principles of EU Law*, (Oxford: Oxford University Press, 2006), at p. 243.

28. Pauwels, *supra* note 1, chapter 4. Compare J. Raitio, *The Principle of Legal Certainty in EC law*, (Dordrecht/Boston/London: Kluwer Academic Publishers, 2003), at p. 125, who considers the principle of legal certainty as a 'multi-faceted principle' and J. Temple Lang, 'Legal certainty and legitimate expectations as general principles of law', in: U. Bernitz et al., eds., *General Principles of European Community Law*, (Den Haag: Kluwer Law International, 2000), at p. 164 who uses the term 'umbrella principle'.

29. Fuller *supra* note 2, at pp. 46-91.

30. Gribnau and Pauwels, *supra* note 5, at pp. 145-149.

31. See, for example, the important and comprehensive study by Popelier on the principle of legal certainty: P. Popelier, *Rechtszekerheid als beginsel voor behoorlijke regelgeving*, (Antwerpen: Intersentia, 1997).

tive legislation. Both are caused by legislative inconstancy. The last demand of Fuller is for congruence between the declared rules and the acts of the administration. This aspect regards the *application* of legislation, not – as the other desiderata do – the quality of legislation itself.

In addition to Fuller's desiderata, the principle of honouring legitimate expectations raised by the law could be addressed as an aspect of legal certainty. This principle is implicitly covered by some of the desiderata, such as the standard of non-retroactivity, the demand that the laws should not be changed too frequently, and the requirement of congruence between the declared rules and the acts of the administration. However, the principle of honouring legitimate expectations raised by the law deserves explicit acknowledgment as an aspect of legal certainty.

2.2.4.3. Retroactivity in view of legal certainty

As mentioned above, the demand of non-retroactivity is an aspect of legal certainty. The principle of non-retroactivity has in my opinion a very solid basis in the principle of legal certainty. Even if the principle of non-retroactivity were not to be explicitly distinguished and characterized as an aspect of legal certainty, the other aspects of legal certainty would entail that laws should as a matter of principle not be retroactive.

First of all, the other desiderata of Fuller would imply that laws should not be retroactive. In essence, these desiderata serve the aim that the law is knowable. Knowable law enables citizens to predict the legal consequences of their actions and therefore to plan their conduct and actions. It is clear that a retroactive law is inherently not capable of doing that. After all, a citizen cannot predict the legal consequences of an action on the basis of the law that only enters into force after the action occurred.

Secondly, a retroactive law is not only incapable of enabling citizens to predict the legal consequences of their actions. A retroactive law also infringes the expectations that were raised by the former law, i.e. the law that was applicable at the moment the action was executed. A citizen expected – based on the then applicable law A – that his action would have legal consequence 'a', but at the end the legal consequences appear to be 'b', based on the retroactive law B.

2.2.4.4. Immediate effect without grandfathering (retrospectivity) in view of legal certainty

How should a law be assessed from the viewpoint of legal certainty if that law is granted immediate effect, without grandfathering? This immediate effect, without grandfathering, entails that the new law applies to all events that occur after the entering into force of the law, including the events that have their origin in actions prior to that moment. For example, suppose that a new tax rule is introduced to the effect that mortgage interest is not deductible for income tax purposes, while under the old tax rule the mortgage interest was tax deductible. Suppose further that the legislator grants immediate effect to that new rule and that he does not provide for grandfathering of existing mortgage loans. Then, the new rule is applicable to all mortgage interest that is paid after the date of entry into force, so also to interest paid on mortgage loans that were concluded prior to that date. The term 'retrospective' is used for this phenomenon.

If the above analysis with respect to retroactivity is applied to retrospectivity, it appears that the same issues arise. First of all, the 'knowability' and predictability of the law are at stake in the sense that a part of the legal consequences of an action are governed by a law that was not yet in force at the moment of that action and which the citizen could therefore not take into consideration when planning that action. I refer in this respect also to the

above-mentioned remark by Fuller on the close affinity between the demand for the constancy and the demand of non-retroactivity.

Secondly, the new law infringes the expectations which the citizen had based on the law that applied when the action was carried out. The citizen expected that mortgage interest would be deductible when he concluded the mortgage loan agreement, but that expectation is not honoured.

Thus, the principle of legal certainty offers arguments *contra* retrospectivity. In positive terms: the principle of legal certainty offers arguments *pro* grandfathering.

2.2.4.5. The difference between retroactivity and retrospectivity: only gradual

The above analysis shows that the arguments *contra* retroactivity are also arguments *contra* immediate effect without grandfathering (retrospectivity). It can be concluded that the distinction between retroactivity, on the one hand, and immediate effect without grandfathering (retrospectivity), on the other hand, loses relevance from the perspective of legal certainty. There is no strict distinction but only a gradual distinction. This is nowadays generally accepted in the legal literature.³²

I note that the conclusion that the difference between retroactivity and immediate effect without grandfathering is only gradual is also supported – even strongly – in law and economics literature on transitional law, which looks at the impact of both.³³ For example, Graetz concludes that ‘the distinctions commonly drawn between retroactive and prospective effective dates are illusory.’³⁴

2.2.5. Principles of transitional law: priority principles

2.2.5.1. Introduction: research question

There are two principles of transitional law that are generally accepted. As far as I am aware, these principles are accepted by the legislator, by the court when it judges the legislator’s transitional law, as well as in the literature. The first principle is that a change in legislation has immediate effect, without grandfathering. Hence, retrospectivity of legislation is generally accepted. The second principle of transitional law is that that a change in legislation should, as a matter of principle, not have retroactive effect.

These principles of transitional law thus involve a relatively sharp distinction between retroactive effect (in principle not permissible) and immediate effect (in principle permissible). However, section 2.2.4 of this contribution reveals that, from the perspective

32. See in particular Popelier, *supra* note 31, at p. 572 and P. Popelier, *Toepassing van de wet in de tijd. Vaststelling en beoordeling van temporele functies*, (Brussel: Story-Scientia, 1999), at pp. 48 and 178, as well as Pauwels, *supra* note 1, chapter 5, with references to amongst others J.E. Fisch, ‘Retroactivity and legal change: an equilibrium approach’, *Harvard Law Review* (1997), at pp. 1067-1070 and 1087, C. Sampford, *Retrospectivity and the Rule of Law*, (Oxford: Oxford University press, 2006), at pp. 9-37 and B. Juratowitch, *Retroactivity and the Common Law*, (Oxford: Hart Publishing, 2008), at pp. 5-13. Sampford – who uses a broad definition of retrospectivity that also covers what is called retroactivity in this contribution – concludes that ‘retrospectivity does not appear to be an all-or-nothing characteristic of laws but rather is a matter of degree’ and mentions ‘the idea of retrospectivity as a continuum concept.’

33. In this contribution I do not elaborate on this. See Pauwels, *supra* note 1, section 5.3.4., with references to Graetz, *Legal Transitions*, *supra* note 4, at pp. 54-60, Kaplow, *supra* note 4, at pp. 515-519, Logue, *supra* note 6, at p. 1133, Fisch, *supra* note 32, at p. 1067 and Shaviro, *supra* note 4, at pp. 106-108.

34. Graetz, *Retroactivity Revisited*, *supra* note 4, at p. 1822. More nuanced Graetz, *Legal Transitions*, *supra* note 4, at p. 63: ‘the difference in impact between a nominally retroactive change and one which is nominally prospective is often slight.’

of legal certainty and from a law and economics perspective, the difference between a change with retroactive effect and a change with immediate effect is only gradual. The question therefore arises what the justification is of the above-mentioned principles of transitional law. This section deals with this question.

2.2.5.2. Framework for transitional law: principle of legal certainty, the objective of the law, and principle of equality

In my view, the issue of principles of transitional law in tax law should be understood from an abstract framework that is formed by three major principles or, as the case may be, interests. For this triad of interests I am inspired by the above-mentioned theory of Radbruch.

The *first* principle has already been discussed above. It is the principle of legal certainty. Looked at from the point of view of legal certainty, a law should not only have no retroactive effect, but should also have no immediate effect without grandfathering. The principle of legal certainty advocates providing for grandfathering to avoid retrospectivity.

However, if the legislator provides for grandfathering, the new law does not become effective with respect to the cases that are grandfathered. Thus, the objective that is served by the new law cannot be reached to the extent that grandfathering is provided. Suppose a new law is introduced that involves extra taxes on flights by airplanes and that this law has an environmental objective. It is obvious that if existing airplanes were grandfathered, this would not serve that environmental objective. The environmental objective would be better served if the new law were to apply to all flights, including flights by existing airplanes. The *second* interest is therefore ‘the objective of the law’. In particular, the law and economics literature – in my view: correctly – emphasizes that grandfathering has social costs as it entails delay and reduction of the benefits of the new law.³⁵

So from the perspective of ‘the objective of the law’ a new law should have immediate effect without grandfathering. The objective of the law involves an argument *contra* grandfathering and *pro* retrospectivity.

With respect to the issue of retroactivity, the perspective of ‘the objective of the law’ does not provide an argument *pro* retroactivity. After all, as discussed above (section 2.2.4.3), a retroactive law *itself* is not able to guide behaviour.³⁶ Nonetheless, in certain situations, ‘the objective of the law’ could advocate retroactivity. An example is the situation in which a loophole exists in a law. If a new law is introduced to cure this loophole, the ‘objective of the law’ provides an argument *pro* retroactivity of that law. After all, to the extent taxpayers exploit the loophole, the original law fails to meet its own objective.

The *third* principle is the principle of equality. For the viewpoint of the principle of equality on transitional law, I consider to be equal those facts that *ratione materiae* fall within the scope of the new law and that occur in the same period. This definition taken into account, the principle of equality advocates *against* grandfathering. The reason is that grandfathering leads to unequal treatment of facts that fall within the scope of the new law and which occur in the same period. After all, in the case of grandfathering, the new law does not apply to certain facts that occur after the entry into force and that would *ratione materiae* fall within the scope of the new law. Applied to the example above: grandfathering

35. Compare Graetz, *Legal Transitions*, *supra* note 4, at p. 71, S. Levmore, ‘The Case for Retroactive Taxation’, *Journal of Legal Studies* (1993), at p. 290 and L. Kaplow, ‘Transition Policy: A Conceptual Framework’, *Journal of Contemporary Legal Issues* (2003), at p. 173.

36. Note that the *expectation* that a new law may be retroactive obviously may influence behaviour. Based on this notion, some law and economic authors plea for retroactivity in certain situations. For example, if taxpayers know that the tax legislator has the transitional law policy of curing loopholes in the law with retroactive effect, there is an incentive for taxpayers not to exploit new loopholes; compare Kaplow, *supra* note 4, at pp. 551, 587 and 607-610, Kaplow, *supra* note 35, at pp. 181-184 and Logue, *supra* note 9, at pp. 231-235 and 257-259.

of existing airplanes would imply that flights by new airplanes are taxed higher than flights by existing airplanes in the same period. It should be emphasized that this does not imply that the principle of equality *requires* that there should never be grandfathering. My reasoning is only that the principle of equality provides an argument *contra* grandfathering as well as that, from the perspective of the principle of equality, grandfathering needs a justification.

From the above-mentioned viewpoint of the principle of equality on transitional law, the principle of equality does not provide an argument *pro* or *contra* retroactivity. Based on another viewpoint, it could however be argued that the principle of equality may provide an argument against retroactivity. The basic idea is then that retroactivity implies that unequal cases are treated equally, as all facts that arose prior to the promulgation of the new law are treated as equal to facts arisen after the promulgation. However, in my view, this argument is in essence strongly interrelated with the argument of legal certainty. After all, the reason for considering these facts as unequal is that in the former case the law was not yet in force when the facts arose, while in the latter case the law is in force when the facts arise.

It should be noted that in a concrete legislative case of transitional law other principles or interests could also be involved in addition to the three just discussed. Such other principles are for example the principle of legality, the principle of equality of arms (which could be infringed if a retroactive law influences pending proceedings for the judiciary) and the ability-to-pay-principle. Nonetheless, these principles and interests are in my view the most important, as they are involved in almost all legislative cases of transitional law. This does not imply that other principles are not relevant. After all, these principles should indeed be taken into account in the balancing process insofar they are involved in the legislative case at hand.

With respect to the issue of retroactivity, the above shows that (i) the principle of legal certainty provides strong arguments *contra* retroactivity, (ii) the principle of equality does not provide an (additional) argument *pro* or *contra* retroactivity and (iii) from the perspective of 'the objective of the law' there *may* be an argument *pro* retroactivity in certain situations.

With respect to the issue of immediate effect without grandfathering, the conclusion is that (i) the principle of legal certainty advocates grandfathering, (ii) the principle of equality provides an argument *contra* grandfathering and (iii) from the perspective of 'the objective of the law' there should be no grandfathering.

2.2.5.3. **The principles of transitional law should be conceptualized as 'priority principles'**

On the basis of the above, a theoretical foundation can be given for the generally accepted principles of transitional law, viz. the principle of immediate effect without grandfathering and the principle of no retroactivity. In my view, these principles of transitional law should be conceptualized as – what I call – 'priority principles'.

The 'priority' element relates to the idea that the principles of transitional law should be regarded as the result of a process of balancing which results in the priority of one interest or principle over the other. As the analysis in the previous section shows, the three principles and interests involved provide arguments in different directions with respect to an adequate transitional law. Hence, a balancing of these principles or interests is necessary.

The principle of non-retroactivity is the result of the balancing of these principles and interests in the sense that the principle of legal certainty – that provides an argument *contra* retroactivity – prevails and has priority over any other interests. As to the principle of immediate effect without grandfathering, the objective of the law and the principle of equality – which provide arguments against grandfathering – outweigh the principle of legal certainty – which advocates grandfathering.

The ‘principle’ element of ‘priority principles’ refers to the fact the two results of balancing the three principles and interests are only *prima facie* results. The results – immediate effect without grandfathering and no retroactivity – are not rules: they do not dictate – as rules do – but indicate a direction, as principles do. The results should therefore not be characterized as priority *rules* but as priority *principles*. The balancing results are the results of an abstract balancing of the three principles or interests. In a concrete legislative case of transitional law, the results of balancing may differ. On the one hand, due to the circumstances of the case, one or more of the three principles or interests could have more or less weight than the weight taken into account in the abstract balancing. On the other hand, in a concrete legislative case, there could also be other principles or interests involved that should be taken into account when balancing and making transitional law.

Finally, it should be noted that the above provides a theoretical foundation for the generally accepted principles of transitional law. Based on the framework that is constituted by the principle of legal certainty, ‘the objective of the law’, and the principle of equality, the principle of immediate effect without grandfathering and the principle of non-retroactivity can be justified in terms of balancing results. It is, however, not possible to fully substantiate why *these* are the abstract balancing results and why for example grandfathering for one year is not a more optimal balancing result. This relates to the more general issue of incommensurability of principles, referred to in section 2.2.3.2.

2.2.6. Legitimate expectations? An approach based on ‘the method of the catalogue of circumstances’

2.2.6.1. Introduction: the problem and research question

The legislator can rely on two principles of transitional law, viz. the principle of immediate effect without grandfathering and the principle of non-retroactivity. The above confirms that these principles are indeed principles and not rules. Therefore, in a concrete legislative case, there could be reasons for the legislator to deviate from these principles.

To answer the question as to whether in a concrete case there is reason to deviate from the principles of transitional law, the concept of ‘legitimate expectations’ has an important role. If taxpayers are deemed not to have legitimate expectations in the legislative case at hand, the principle of legal certainty has less weight and there may thus be reason to grant retroactive effect. The other way around, if immediate effect without grandfathering were to infringe upon legitimate expectations of taxpayers in the legislative case at hand, the principle of legal certainty has more weight and there is more reason to provide for grandfathering. Accordingly, the question as to whether or not taxpayers have ‘legitimate expectations’ plays an important role when the principles of transitional law are applied.

However, the concept of ‘legitimate expectations’ is generally problematic. In the first place, the term ‘legitimate expectations’ is often used to indicate that expectations are at stake that partially or completely *should be* honoured. If used in this way, an important step has already been passed. This is the step in which the principle of honouring legitimate expectations is balanced against any interests that advocate contra honouring the expectations (‘counter-interests’). The adjective ‘legitimate’ then points in particular to the final result, and is useless for the answer to the question as to under which circumstances expectations should be honoured. In the second place: even if the term ‘legitimate expectations’ is only used for stating that it concerns expectations that are reasonable and could qualify to be honoured, the term remains a vague one. For when are expectations ‘legitimate’? The latter question is the research question I deal with in this section. Though the usage does not have my preference I avoid confusion by following the usual legal terminology indicated above with regard to the term ‘legitimate expectations’. Hence, ‘legitimate expectations’ are expectations that should be honoured.

2.2.6.2. An initial theoretical framework to approach the concept 'legitimate expectations'

The above indicates that the concept of 'legitimate expectations' is vague and somewhat problematic. The question is whether it is possible to provide some support to the legislator for assessing when the expectations at hand can be characterized as 'legitimate'. In this section an initial theoretical framework to approach the concept 'legitimate expectations' is developed.

In my view, conceptually, two steps can be discerned when it comes to the assessment of whether in a concrete case expectations are 'legitimate'. The first step concerns the question as to whether the subjective expectations in the case at hand are reasonable. If the answer is affirmative, the second step is to answer the question whether the reasonable expectations are legitimate expectations. If the answer to the latter question is also affirmative, the expectations should be honoured.

Sometimes, there is still a third step. That step concerns the question *to what extent* expectations ought to be honoured. The conclusion that the expectations at hand are legitimate does not automatically mean that the expectations ought to be fully honoured. For example, if the existence of legitimate expectations entails that the legislator should provide for grandfathering, this does not necessarily imply that the grandfathering should be unlimited in time. Grandfathering for a couple of years could be more appropriate.

The first step – from subjective expectations to reasonable expectations – concerns a process of filtering by objectification. The process of objectification takes place by taking the view of a reasonable person.³⁷ The second step concerns a balancing of the expectations with the 'counter-interests' (the interest that would be infringed if the expectations were to be honoured). The factors that are significant for the first step are also significant for the balancing involved in the second step. They are of influence for answering the question how important it is that the expectations are honoured. Thus, notwithstanding that the two steps can conceptually be distinguished, in practice the two steps are actually hard to discern. The third step is interrelated with the second step. After all, the question to what extent expectations ought to be honoured also concerns a process of balancing with 'counter-interests'.

This framework gives the legislator something to hold on to, but it has its limits. For example, the idea of objectification is helpful, but the question as to whether expectations are reasonable cannot be answered without information about the circumstances of the case. Further, the question as to whether expectations are legitimate cannot be considered apart from the weight of the 'counter-interests'. Which counter-interests are involved and the weight of these counter-interests also depends on the circumstances of the case. The concept of 'legitimate expectations' therefore remains a concept that is difficult to grasp in abstracto. Ultimately, the circumstances of the case are decisive.

However, is it possible to offer the legislator more than the answer 'that depends upon the circumstances of the case' with respect to his assessment of the legitimacy of expectations? To answer this question, in the next section, the Netherlands case law with respect to the principle of protection of legitimate expectations as a general principle of proper administration in tax law is examined.

37. Compare the 'prudent and circumspect trader' in the case law of the ECJ, for example ECJ C-37-38/02, 15 July 2004, *Case Di Lenardo en Dilexport*, para. 70. See also Raitio, *supra* note 28, at p. 218, as well as S.J. Schönberg, *Legitimate Expectations in Administrative Law*, (Oxford: Oxford University Press, 2000), at p. 6: 'An expectation is reasonable if a reasonable person acting with diligence would hold it in the relevant circumstances.'

2.2.6.3. Method of priority rules?

Obviously, the question how to approach the concept of 'legitimate expectations' is relevant in more areas than the field of transitional law only. For example, in the doctrine of the principle of honouring legitimate expectations as a general principle of proper administration in tax law, the judiciary has also to deal with the concept 'legitimate expectations'. Also in that field the question is when expectations should be honoured. It concerns the issue in which circumstances the principle of honouring of legitimate expectations justifies a deviation from the strict application of the legislation. In terms of balancing principles, it concerns balancing the principle of legality and the principle of honouring of legitimate expectations. Interestingly for this subject, the Netherlands Supreme Court has succeeded in developing a certain method that offers clear guidelines. This method is the method of 'priority rules'.³⁸ The question arises whether this method could be useful to approach the concept of 'legitimate expectations' in the field of transitional law.

The Supreme Court has distinguished several particular types of situations ('standard situations') in which the tax administration could cause taxpayers to develop expectations. The distinction is based on the origin of the expectations. Such standard situations are amongst other ones expectations raised by a policy rule of the tax administration, expectations raised by a promise of the tax inspector, and expectations raised by general information of the tax administration. For each of the standard situations, the Supreme Court has developed rules for the balancing of principles, resulting in 'priority rules'. Such a priority rule indicates under which circumstances the principle of honouring of legitimate expectations outweighs – and therefore gets priority above – the principle of legality.

To illustrate this, I refer to the priority rule for promises. This priority rule prescribes that the expectations raised by a promise are honoured (which thus implies an application that deviates from the legislation) in case (i) the taxpayer has the impression that the tax inspector takes a certain position concerning his application of the tax law, (ii) the taxpayer has told the tax inspector all relevant facts and circumstances of his case, (iii) the taxpayer may reasonably think the promise is in the spirit of the law, and (iv) the tax inspector is competent to deal with the taxpayer.

A characteristic of a priority rule is that it has the same structure as a statutory provision. Just like a statutory provision, a priority rule sets out criteria. In a concrete case, it should be verified whether all the criteria are met. If the criteria are all met, the rule applies. In that case the expectations concerned are considered legitimate and are honoured. In other words, the principle of honouring legitimate expectations then has priority above the principle of legality. If one of the criteria is not met in the case at hand, the priority rule is not applied. In that case, the principle of legality gets priority and the expectations are not honoured.

From the perspective of the question how to approach the concept of legitimate expectations, it is interesting to note that, first of all, a priority rule, in particular its criteria, provides a *selection* of the circumstances that are relevant for the standard situation concerned. The judiciary only has to investigate whether these circumstances are present in the case at hand. The judiciary does not need to examine the presence of other circumstances. Secondly, a priority rule in fact determines which circumstances on their own are a *necessary condition* to assume 'legitimate expectations'. If one of the circumstances included in the priority rule is not present in the case at hand, the principle of legality prevails and the

38. See Richard Happé and Melvin Pauwels, 'Balancing of powers in Dutch tax law: General overview and recent developments', in: C. Evans, J. Freedman, & R. Krever, ed, *The delicate balance: Tax, discretion and the rule of law* (Amsterdam: IBFD, 2011), and, in depth, R.H. Happé, *Drie beginselen van fiscale rechtsbescherming*, (Deventer: Kluwer, 1998).

expectations at hand are not honoured. Thirdly, a priority rule determines which circumstances together are a *sufficient condition* to assume 'legitimate expectations'. If all circumstances that are included in the priority rule are present in the case at hand, the expectations are considered legitimate and are honoured. Thus, other circumstances are not relevant.

The above shows that the method of priority rules has important benefits. Notwithstanding these benefits, in my opinion, the method of priority rules is not suitable as general method in the field of transitional tax law. It may be possible to provide a priority rule for one or more specific types of situation. But as a general method, it is in my opinion too rigid in the field of transitional tax law. The situations that may arise are too varied to cover the whole field with priority rules. More flexibility is needed. This is, amongst other things, caused by the fact that in the field of transitional law the 'counter-interests' vary in number and weight depending on the circumstances of the case.

2.2.6.4. Method of the catalogue of circumstances

In the previous section I discussed the method of rules of priority to approach the concept of 'legitimate expectations'. I concluded that this method has important benefits, but that it is not suitable as a general method in the field of transitional law. This does not mean, however, that as to the question when expectations may be called legitimate, we are completely thrown back on the 'open' answer 'that depends upon the circumstances of the case'.

An appropriate method for approaching the concept of 'legitimate expectations' in the field of transitional law, in my opinion, is the method of the catalogue of circumstances. This method takes an intermediate position between only a non-specified reference to the circumstances of the case (an 'open group of circumstances'), on the one hand, and the method of priority rules, on the other hand. In the context of making transitional law, the method of the catalogue of circumstances means that the legislature ought to assess whether the circumstances listed in the catalogue are present in the legislative case at hand and that it must take these circumstances into consideration when balancing the various principles and interests involved. An open catalogue of circumstances is preferable to an exhaustive one because it cannot be ruled out that in a concrete case of law-making a special circumstance is present that also deserves to be taken into consideration but that is not included in the catalogue.

A difference from, and an advantage in comparison to, an 'open group of circumstances' is that the method of the catalogue of circumstances determines *which circumstances* ought to be taken into consideration (as far as they are present in the legislative case at hand). The method has this feature in common with the method of priority rules. A difference with that latter method is, however, that it still leaves open what the impact is of the circumstances. Other than in the method of priority rules, neither which circumstances are *necessary conditions* nor which circumstances together are a *sufficient condition* for expectations to be honoured has been determined. This is also caused by the fact that the weight of the 'counter-interests' is unknown.

An advantage of the method of the catalogue of circumstances is that it provides the legislator a foothold for balancing, because it is clear which circumstances the legislator in any case should take into account when balancing the colliding interests. The method also has the advantage that, to a certain extent, it urges the authority who submits a bill to parliament to provide reasons for his proposal with respect to the transitional law that is proposed in the bill. This may contribute to the transparency of the legislative proposal and may add to the quality of the balancing. The quality of the balancing may be improved

because parliament can verify whether or not the authority who submitted the bill³⁹ has ignored any relevant circumstances. Thus, the risk may be diminished that a particular circumstance that should be taken into account in the balancing process is ignored. Further, the quality of the balancing may be improved, because if the authority that submits the bill is urged to explain which circumstances it has taken into consideration, parliament can verify whether each of the circumstances adduced is actually present and whether each of the circumstances has indeed the impact that the authority claims it has.

2.2.6.5. The interaction between the method of the catalogue of circumstances and the priority principles of transition

Hence, in my opinion, the method of the catalogue of circumstances is an appropriate method for the legislator to approach the concept of legitimate expectations in the field of transitional law. In section 2.2.5, I argued that the legislator should apply the priority principles of transitional law, viz. the principle of immediate effect without grandfathering and the principle of non-retroactivity. I would like to emphasize that these two conclusions are neither contradictory nor inconsistent. To the contrary, they complement each other.

First of all, the priority principles of transitional law gain more significance through the catalogue of circumstances. Due to the catalogue of circumstances, it is clear which circumstances the legislator should take into account when the principles of priority are applied. Secondly, there is an interaction. As far as retroactivity is concerned, the point of departure in a concrete case of transitional law-making is that granting retroactive effect would lead to a breach of legitimate expectations. The method of the catalogue of circumstances is then used to scrutinize whether or not the circumstances of the legislative case nevertheless justify the conclusion that the expectations at hand have less weight than the 'counter-interests'. Further, conversely, as far as immediate effect without grandfathering is concerned, the point of departure in a concrete case of transitional law-making is that immediate effect without grandfathering does not lead to a breach of legitimate expectations. The method of the catalogue of circumstances is then used to scrutinize whether the circumstances of the legislative case nevertheless justify the conclusion that the expectations should be honoured by providing for grandfathering.

2.2.7. The catalogue of circumstances for making of transition law

2.2.7.1. The contents of the catalogue of circumstances

In the previous section, I advocated the method of the catalogue of circumstances to approach the concept of legitimate expectations, which concept is relevant for the application of the priority principles of transitional law. This plea for the method of the catalogue of circumstances (in combination with the priority principles of transitional law) was based on a theoretical investigation of ways to deal with the concept of legitimate expectations. The question, however, arises whether the method can actually be applied in practice. Is it possible to draft a catalogue of circumstances that the legislator should take into account in balancing the colliding interests when making transitional law? And if so, which circumstances should be included in the catalogue of circumstances, and what is the impact of each of these circumstances?

39. In the Netherlands, it usually is the State Secretary of Finance who draft bills and submits bills to parliament; see for example Hans Gribnau, 'Separation of Powers in Taxation: The Quest for Balance in the Netherlands', in: Ana Paula Dourado, ed., *Separation of Powers in Tax Law*, EATLP International Tax Series volume 7 (Amsterdam: IBFD, 2010) and Happé and Pauwels, *supra* note 38.

To answer these questions I scrutinized various legal sources. These sources are actual transitional law enacted by the Netherlands legislator and the related legislative history (such as Explanatory Notes to the bill, parliamentary advisory opinions on draft legislation by the Netherlands Council of State, and reports of the parliamentary debate), case law (Netherlands case law, case law of the European Court of Justice and case law of the European Court of Human Rights) and the literature (Netherlands as well as foreign). I systematically analysed these legal sources on the issue of which circumstances were considered relevant for the balancing to be made in the transitional law at hand (or – with respect to case law – for the judgment by the court with respect to the transitional law enacted). For convenience of comparison, I reasoned from a balancing of two interests: on the one hand – contra retroactivity and retrospectivity – the principle of legal certainty and, on the other hand, the interests that may be served by retroactivity or retrospectivity (‘counter-interests’). Thus, for each circumstance that appeared to be relevant the relevance was assessed: does the circumstance positively or negatively influence the weight of the principle of legal certainty or of the counter-interest?

Based on this investigation and analysis I conclude that the first question can be answered in the affirmative: yes, it is possible to draft a catalogue of circumstances for making of transition law. The analysis shows that certain circumstances continuously play a role in discussions and reasoning with respect to making of transition law in the field of taxation. These circumstances should be included in the catalogue of circumstances for making of transition law. Also the second question (which circumstances?, and what is the impact of each of them?) can be answered on the basis of the research. I present the results in the table below.

Table 2-1.

Circumstance	Remarks	Impact on the weight of	
		Legal certainty	Counter-interests
Area of law: tax law	– ‘Affects the balancing’		
	– Type of tax also relevant		
	– Always a counter-interest in the administration’s financial interest		
	– Asymmetrical legal relationship	Positive	
	– Negative effect on financial position of citizens		
	– Administration directly concerned		
	– Variability tax legislation	Negative	
Announcement effects to be expected			Positive
Predictability of amendment		Negative	
	– Question of gradation		
	– Circumstances of the case		
	Types of situation:		
	– ‘Legislation by press release’		
	– ‘Evident omission’		

Circumstance	Remarks	Impact on the weight of	
		Legal certainty	Counter-interests
	Factors: <ul style="list-style-type: none"> – Notion: relying on invariability of law not allowed: – Length of time horizon – New developments – Taxpayer's status – Place of provision in legal system – Statements by Deputy Minister for Finance – Illegal context – Imbalance or injustice 		
Taxpayers' behaviour: disposition	<ul style="list-style-type: none"> – Question of gradation – Weight depending also on the nature of the transaction and the nature of the rule to be amended – Connection with damage 	Positive	
Taxpayers' behaviour: tax avoidance	<ul style="list-style-type: none"> – Criteria defining 'tax avoidance' difficult 	Negative	Positive
Behaviour of the government: legislature's duty of care	Particularly relevant as counter circumstance related to: <ul style="list-style-type: none"> – Tax avoidance – Interference by legislature in response to case law – Evident omission 		
	<ul style="list-style-type: none"> – Infringement of proactive or reactive duty of care 	Positive impact on relative weight legal certainty	
	<ul style="list-style-type: none"> – General counter circumstance: reason of amendment at the legislature's risk 	Positive impact on relative weight legal certainty	
Behaviour of the government: statements by the government	<ul style="list-style-type: none"> – Statement that legislation will not be amended – Statement that legislation will be amended 	Positive	Negative
Behaviour of the administration: consistency	<ul style="list-style-type: none"> – Circumstance that a comparable transitional situation exists for which previously transitional law had been made 	Impact on the balancing of interests depends on previous transitional law	
Particulars of legislative changes	<ul style="list-style-type: none"> – Policy-related provision – Provision in area where long-term planning is important – Express statement (e.g. exemption) – Time frames in statute 	Positive	Positive

Circumstance	Remarks	Impact on the weight of	
		Legal certainty	Counter-interests
	<ul style="list-style-type: none">- Appropriate transitional regime of future changes laid down by statute	Positive	
	<ul style="list-style-type: none">- Evident omission in legislation	Negative	Positive
	<ul style="list-style-type: none">- Obscurity in legislation	Negative	Positive
Allocation possible to period before entry into force	Types of situations: <ul style="list-style-type: none">- Inextricable connection with legal fact from the past- Recapture of past event- Compartmentalization (tax basis partly accrued in the past)	Positive	
Formalized legal status		Positive	
Possibility for adjustment	<ul style="list-style-type: none">- Adjustment possible (impossible)	Negative (Positive)	
Uncompleted complex of transactions		Positive	
Damage/detriment	<ul style="list-style-type: none">- Damage due to amendment	Positive	
	<ul style="list-style-type: none">- Nature of damage: damage due to disposition	Positive	
	<ul style="list-style-type: none">- Nature of damage: removing 'windfall profit'	Less positive	
	<ul style="list-style-type: none">- Compensation for damage	Negative	

In this contribution, it is not possible to discuss this table and each of the mentioned circumstances in detail.⁴⁰ This would not only take too much room it is also not necessary for the purpose of this contribution. After all, the main goal of this contribution is to show that the method of the catalogue of circumstances is a suitable method, in combination with the priority principles of transitional law, for making of transition law.

It is nonetheless helpful to exemplify the table. Therefore, I briefly discuss two circumstances in the next section. These circumstances are (i) 'taxpayers' behaviour: tax avoidance', and (ii) 'behaviour of the government: legislature's duty of care', in particular in the situation of tax avoidance.

2.2.7.2. Two circumstances discussed

One of the circumstances that should be taken into account by the legislator when making transitional law is the circumstance that 'tax avoidance' occurs under the existing legislation. The table indicates that this circumstance, on the one hand, has a negative effect on the weight of the principle of legal certainty and, on the other hand, a positive effect on the weight of the counter interests. The table indicates that it is difficult to sharply define the

40. In my PhD.-dissertation I discussed each circumstance in more detail in about 150 pages in total.

concept of ‘tax avoidance’. I note that in any case the concept includes ‘tax abuse’, but I will not expand further on this conceptual issue. I focus on the above-mentioned effects.

The negative effect on the weight of the principle of legal certainty, on the one hand, and the positive effect on the weight of the counter interests, on the other hand, thus implies that when ‘tax avoidance’ is present, this lowers the *relative* weight of the principle of legal certainty. In relation to the principles of transitional law this means that if anti-avoidance legislation is introduced (i) there is less reason to provide for grandfathering and (ii) there is more reason to grant retroactive effect (for example, till the moment of an announcement by the government that it will propose introducing anti-avoidance legislation; the technique of ‘legislating by press release’).

However, the above does not yet provide arguments for the above-mentioned effects. In my opinion, these effects have a solid theoretical basis. With respect to the principle of legal certainty, it should be noted that taxpayers who seek out the boundaries of the law and who exploit loopholes can reasonably expect that eventually the legislator will target the tax avoidance concerned. Moreover, the question can be raised whether expectations based on a loophole can fairly be regarded as ‘reasonable’, let alone ‘legitimate’. With respect to the ‘counter interests’, it should be noted that there are interests that are especially served in case the anti-avoidance rule has a broad reach. First, as the purpose of the existing tax rules is undermined by the avoidance of these rules, a broad reach of the anti-avoidance rule serves that purpose. Secondly, a broad reach could enhance equality of taxpayers.⁴¹ After all, taxpayers who are in fact in a comparable economic position could have a different tax burden depending on whether or not the taxpayer exploits the loophole in the legislation. Further, from a more extensive point of view on the principle of equality, the principle of equality is at stake, because tax avoidance comes at the expense of the other taxpayers.

Analysis of various legal sources shows that it is generally accepted that the existence of tax avoidance, or at least of tax abuse, has a negative impact on the relative weight of the principle of legal certainty. In the Netherlands, the legislative practice indicates that in the case of anti-abuse legislation the legislator usually does not provide for grandfathering and that it sometimes provides for retroactive effect. Not only in Netherlands legislative practice, but also in the legislative practice of other countries the view is apparently that retroactivity may be justified in the case of tax avoidance.⁴² Furthermore, also in the academic literature it is recognized that retroactivity could be appropriate in the case of abuse or improper use of legislation.⁴³ Moreover, support can be found in judgments of international courts. Several decisions of the ECtHR⁴⁴ suggest that this court will not consider retroactivity of tax legislation contrary to Article 1 of Protocol No. 1 ECHR in case the legislation at stake targets tax avoidance.⁴⁵ Furthermore, the *Gemeente Leusden / Holin Groep* (C-487/01 and C-7/02) case of the ECJ is interesting. That case did not concern retroactivity but retrospectivity of a Netherlands anti-abuse measure in the field of VAT. The ECJ considered (paragraph 79): ‘as regards tax avoidance, although, under the law of a Member State, a taxpayer cannot be censured for taking advantage of a provision or a lacuna in the legislation which, with-

41. E.g. in the *M.A.* case (ECtHR no. 27793/95, 10 June 2003,) the ECtHR upheld the retroactive tax legislation at stake taking into account the legislator’s ‘aim of ensuring equal treatment of taxpayers.’

42. See for example the Report of the Tax Law Session of the 17th Congress of the International Academy of Comparative Law, 2006: H. Ordower, ‘General report’, *Michigan State Journal of International Law* (2007), at p. 186.

43. See e.g. V. Thuronyi, *Comparative Tax Law* (Den Haag: Kluwer Law International, 2003), at p. 76. A. Harper, ‘Tax post facto’, *British Tax Review* (2006), pp. 395-399 and Sampford, *supra* note 32, at pp. 92-93 and 147-151.

44. Case No. 8531/79, 10 March 1981, *A.B.C. en D.*, Nos. 21319/93, 21449/93 and 21675/93, 23 October 1997, *National & Provincial Building Society c.s.*, and No. 27793/95, 10 June 2003, (*M.A.*).

45. Pauwels, *supra* note 1, at pp. 253 and 423, cf. P. Baker, ‘Retroactive Tax Legislation and the European Convention on Human Rights’, *British Tax Review* (2005), at p. 8.

out constituting an abuse, has allowed him to pay less tax, the repeal of legislation from which a person (...) has derived an advantage cannot, as such, breach a legitimate expectation based on Community law.'

The second circumstance that I would like discuss for the purpose of illustration is the circumstance 'behaviour of the government: legislature's duty of care'. This circumstance is amongst other ones relevant in the situation of tax avoidance. Notwithstanding the above, it is important that the legislator does react with sufficient speed to tax avoidance. In case the legislator neglects to combat a certain form of tax avoidance that it has known about for a long time, this has an impact on the balancing of interests with respect to retroactivity or retrospectivity. If the legislator infringes its 'duty of care' to react with sufficient speed, this has a positive impact on the relative weight of the principle of legal certainty. This can be substantiated as follows.

As mentioned above, if taxpayers seek out the boundaries of the law and exploit loopholes, they can reasonably expect that the legislator will target the tax avoidance involved. However, if the legislator does not respond by introducing legislation that targets the tax avoidance, one may argue that the weight of the principle of legal certainty increases again. The idea is that taxpayers may start to wonder whether or not the loophole concerned is indeed a loophole, as the legislator has not reacted.

A second element is that in case the legislator neglects to react with sufficient speed, it is harder to maintain that the interest that is served by retroactivity is really very weighty. After all, one could reason that the legislator definitely would have responded earlier if the interest indeed had been very weighty. A slow legislator, therefore, suggests a lack of urgency. An example is the *Stichting Goed Wonen II* judgment of the ECJ (C-376/02), concerning a case in which the instrument of 'legislation by press release' (retroactive effect until the moment of the earlier announcement by press release) was used by the Netherlands government when introducing an anti-abuse rule. Advocate General Tizzano stated that 'the retroactive effect of the amending law was not 'necessary' to achieve the aim, stated by the Netherlands Government, of combating an 'unintended use' of the tax legislation (...). Indeed, it is difficult to argue that, in a situation such as the present one, the aim of putting a stop to actions which were in themselves lawful and had been continuing for some years could be usefully pursued only by means of a law having retroactive effect. Indeed, given that in this case there was no sudden discovery of an unforeseen and unforeseeable situation, a law prohibiting 'undesirable' devices for the future alone would have made it possible to put a stop to them, whilst causing only slight economic damage (being limited in time and in any event linked to behaviour that had long been tolerated) and without seriously undermining the principle of legal certainty.' I note that it is true that the ECJ did not follow the final conclusion of the Advocate General, but this does not mean that the ECJ rejected Tizzano's reasoning. After all, when the ECJ ruled that the 'necessary'-requirement may have been met, it did not refer to the argument of combating the unintended use, but held that the aim to prevent an announcement effect might justify the retroactive effect in question.

The above shows why the table indicates that the circumstances 'behaviour of the government: legislature's duty of care' is a 'counter circumstance' if that duty of care is infringed. The circumstance 'behaviour of the government: legislature's duty of care' is mainly a correction to the impact of another circumstance. Applied to the above: the circumstance 'tax avoidance' has a negative impact on the relative weight of the principle of legal certainty, but the circumstance that the legislator infringed his duty of care calls for a correction to that impact, making the impact at least less negative. It is, however, not possible to state in general what the final impact of both circumstances is. In a concrete case both circumstances should be balanced.

A fine example of this balancing in a concrete case can be found in the Netherlands legislative practice regarding a bill that was submitted to target a particular type of tax

avoidance. In the Explanatory Memorandum the State Secretary of Finance explained why the bill provided for grandfathering (limiting the retrospectivity) although the bill concerned was an anti-abuse rule: 'With respect to the application field of a new rule, in general a new rule has immediate effect, in especial in case the new rule has an anti-abuse character. (...) On the other hand, it cannot be denied that a pure immediate effect would have undesirable consequences in the case at hand. (...) Therefore, it is proposed to provide for grandfathering to a certain extent (...). The reason is that (...) the legislator has neglected to provide for a proper regulation for years.'⁴⁶

2.2.8. Conclusion

In the introduction I raised the question how the tax legislator should deal with the various colliding interests when making transitional law. In this contribution, I advocate a framework for the tax legislator, based on a principle-based approach. This framework consists of two parts.

The first part concerns the principles of transitional law. These principles are the principle of immediate effect without grandfathering and the principle of non-retroactivity. These principles are generally accepted. In this contribution, I argued that these principles should be conceptualized as 'priority principles'. With respect to the theoretical foundation of these principles, I showed that they can be regarded as the result of the abstract balancing of the three main principles (or interests) involved when making transitional law. These are the principle of legal certainty, the principle of equality and 'the objective of the law'. From this perspective, the transitional law principle of non-retroactivity is the result of the balancing in the sense the principle of legal certainty prevails and has priority over any other interests. As to the principle of immediate effect without grandfathering, the objective of the law and the principle of equality – which provide arguments against grandfathering – outweigh the principle of legal certainty – which advocates grandfathering.

The second part of the framework consists of the method of the catalogue of circumstances. In a concrete legislative case there may be reasons to deviate from the principles of transitional law. In that respect the concept of 'legitimate expectations' is important. On the one hand, if no legitimate expectations are infringed, retroactivity may be permissible. On the other hand, if the immediate effect (retrospectivity) were to infringe legitimate expectations, the legislator should provide for grandfathering. The question is, however, when expectations can be considered 'legitimate'. It is argued that several steps could be distinguished. The first step – from subjective expectations to reasonable expectations – concerns a process of filtering by objectification of the expectations. This implies that the view of a reasonable person is taken. The second step concerns a balancing of the expectations with the interests that would be infringed if the expectations were to be honoured. Although these steps provide something to hold on, in the end the question cannot be answered in abstracto, but depends on the circumstances of the case. I argued that the method of the catalogue of circumstances is helpful in this respect. Such a catalogue consists of the circumstances which the legislator should take into account when balancing the colliding interests (as far as the circumstances are present in the legislative case at hand). This method not only provides the legislator a foothold for balancing, it may also contribute to the transparency and quality of the balancing during the legislative process. Finally, I showed that the method of catalogue of circumstances is not a mere theoretical idea. Based on an investigation and analysis of various legal sources, I showed that it is actually possible to draft a catalogue of circumstances that the legislator should take into account in balancing the colliding interests when making transitional law.

46. *Kamerstukken II (Parliamentary Proceedings of the House of Representatives) 2004/05, 30 I17, no. 3, at pp. 3 en 8.*

Lastly, I note the following with respect to the normative and empirical support for the framework that I advocate. The combination of the priority principles of transitional law, on the one hand, and the method of the catalogue of circumstances, on the other hand, is not directly traceable in parliamentary proceedings, case law and the literature.⁴⁷ However, this combination does find strongly support in these sources. In any of these sources it becomes apparent, explicitly or implicitly, (a) that immediate effect without grandfathering and non-retroactivity are considered the starting points for making of transition law, (b) that 'legitimate expectations' do function as a correction mechanism with regard to these points of departure and (c) that certain circumstances can be pointed out that should be taken into account when balancing the colliding interests when making transitional law. Hence, the framework that I advocate is not only normative but also descriptive.

47. Note, however, that my approach has in its outline many similarities with the approach of Popelier, *supra* note 32.